HOUSE BUDGET COMMITTEE

Democratic Caucus

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REVISED July 25, 2005

Republican Plans for Social Security Private Accounts Raise More Questions, Answer None

House and Senate Republicans have introduced legislation to divert Social Security's annual cash surpluses into voluntary private accounts. Senate Republicans introduced their bill (S. 1302) in June, while House Republicans introduced their bill (H.R. 3304) on July 14. While accounting details differ in the House and Senate proposals, the fundamental result is the same. Both plans suffer from the same flaws:

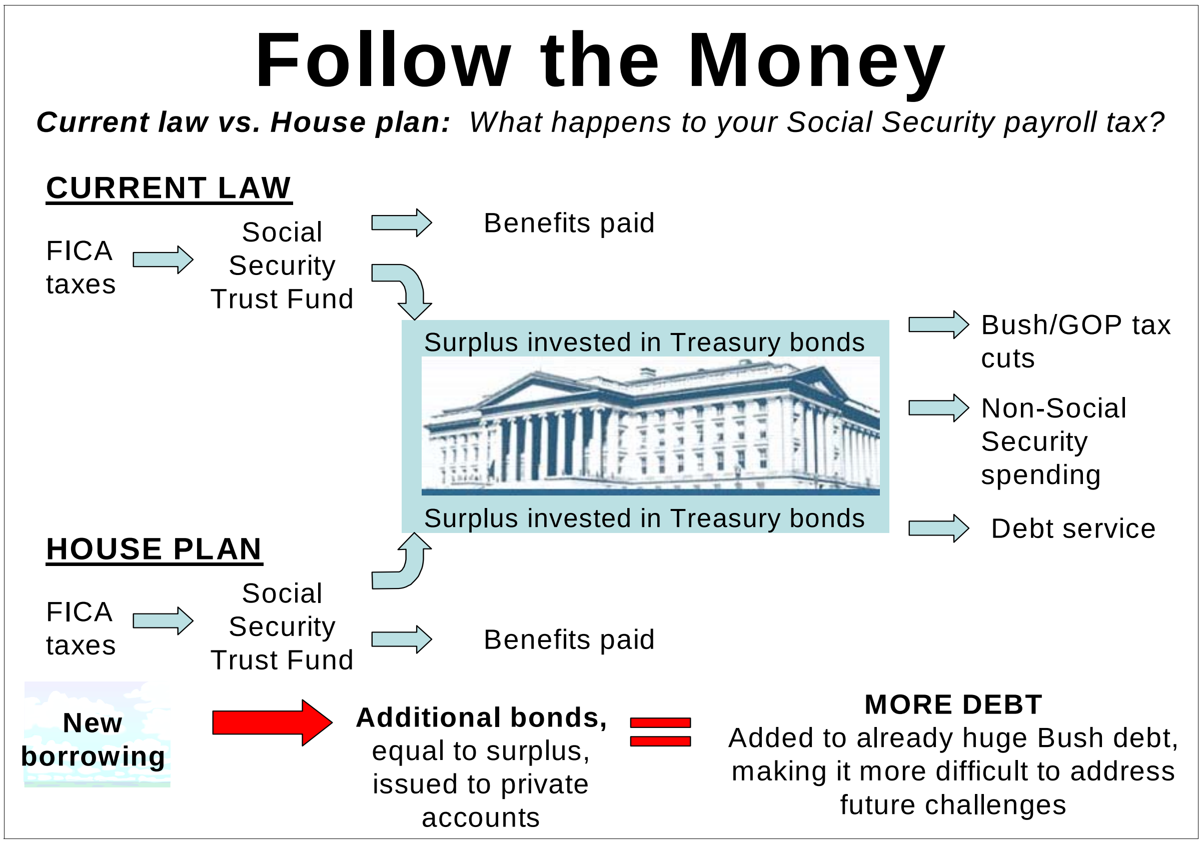
- They increase the publicly held debt held by more than $1 trillion over the next ten years (based on Social Security Administration estimates) in order to privatize Social Security.
- They fail to save the Social Security surplus for promised future Social Security benefits.
- They fail to strengthen Social Security for future generations.
- They fail to explain how the accounts would be funded after 2016, when Social Security surpluses are projected to end.

Description of Republican Plans

***Allocate Social Security Surpluses to Private Accounts* —** Both the House and Senate bills set up a system in which the government makes annual contributions to voluntary private accounts for workers under age 55 based on the size of the Social Security cash surplus each year (excluding interest income). The contribution would be set at a percentage of each worker's Social Security covered wages, so high-wage earners would receive larger account contributions than low-wage workers. Based on projections of the surplus, account contributions would equal 2.2 percent of each worker's covered wages in 2006 and gradually decline to 0.2 percent of wages by 2016. The House and Senate bills differ slightly in their accounting treatment of the surplus:

- ***Senate: Divert Social Security Surpluses Into Private Accounts* —** The Senate Republican bill diverts Social Security's annual surpluses directly into private investment accounts. To make up for these diversions, the legislation provides that general revenue will be transferred to the Social Security trust fund as necessary in order to maintain full benefit payments until 2041, which is when the Social Security Trustees project that the trust fund will exhaust its assets under current law (at which point incoming revenues will be sufficient to cover about three-quarters of scheduled benefits). The Social Security actuaries project that without these general revenue transfers, the Senate plan would cause the trust fund to become insolvent in 2038, three years earlier than is projected to occur under current law.

- ***House: Count Social Security Surpluses Twice* —** Under the House Republican bill, the annual Social Security cash surplus will continue to be credited to the trust fund and invested in Treasury bonds, as under current law. The bill calls for general government funds of an amount equal to the Social Security annual cash surplus to be deposited into private investment accounts. The accounts initially would be invested in Treasury bonds, meaning the cash would flow right back into the federal Treasury (where it would be available to be spent on other things). In other words, the House bill double-counts the Social Security surplus by crediting bonds to both the Social Security trust fund and to the private accounts.



***Social Security Benefits Reduced for Account Holders* —** Both the House and Senate bills apply an offsetting reduction to retirement, aged spouse, and survivor benefits for beneficiaries who have a private account. The bills provide that an account holder's traditional benefit will be reduced by an amount equal to what the account would have earned (after administrative costs) if invested solely in Treasury securities. This offset is similar in structure to the "privatization tax" in the President's plan.

***Accounts Initially Invested in U.S. Treasury Securities* —** The accounts would initially be invested entirely in marketable Treasury securities, but stock index funds and other investment options would be made available starting in a few years (in 2008 under the Senate bill, and in 2009 under the House bill). The House and Senate proposals envision a structure similar to the Thrift Savings Plan for federal employees, in which a central administrative authority would offer workers a limited menu of funds from which to choose.

Implications of Republican Plans

Fixation on Private Accounts Ignores the Real Challenge — Republicans' commitment to converting Social Security to private accounts draws attention away from the core problem, which is how to make Social Security solvent for future generations. Experts estimate that sometime around the middle of this century, the Social Security trust fund will exhaust its assets, and incoming revenues will not be sufficient to cover the full benefits scheduled to be paid. The Senate proposal not only fails to address this looming financial challenge, it makes the problem worse. The Senate plan makes the trust fund insolvent three years sooner and then papers over that problem by providing general revenue transfers that themselves merely represent additional borrowing from the public. The House bill also fails to address the basic problem, and only by relying on a double-counting gimmick does it manage to avoid making the solvency problem worse. In fact, the House and Senate proposals' reliance on general revenues begs the question: if it is acceptable to rely on general revenues – financed with additional borrowing – for the creation of private accounts, why stop there? Why not rely on debt-financed general revenue transfers to keep the trust fund solvent *after* 2041?

Plans Add More Than $1 Trillion to Debt Over Ten Years and Increase Debt Indefinitely — Both the House and Senate plans increase federal deficits and debt held by the public (i.e., debt the government owes to outside lenders) by $1.1 trillion over ten years. The plans result in larger deficits and debt indefinitely because they are not structured to be cost-neutral. Even with the reduction to regular Social Security benefits for account holders, the Republican scheme never pays for itself. This occurs in part because the benefit reduction applied to account holders at retirement does not fully cover the cost of borrowing the funds deposited into their accounts in the first place. In addition, some workers will die before retirement and leave their accounts to their heirs, and the budget will not have a chance to recoup the cost of account contributions from those workers' Social Security benefits. The new borrowing from the public required to fund the accounts will increase the government's net interest payments for decades to come, leaving fewer resources available for investment in important public priorities such as education, health, or protecting the environment. The bottom line is that the federal budget is already running steep deficits, and the House and Senate Republican plans would compel the government to borrow an additional $1.1 trillion from outside lenders over the next ten years in order to fund the workers' accounts.

Does Not Protect the Social Security Surplus for Social Security — Republicans claim their plans will make sure that the Social Security surplus is devoted only to Social Security. This claim is inaccurate on several fronts. First, both the Senate and House bills call for the accounts to initially be invested in Treasury securities, which means the government would simply borrow the money straight from the private accounts to finance its continuing deficits. Second, every dollar of Social Security's surpluses is earmarked for future Social Security benefits; it is not "free money." Putting Social Security surpluses into private accounts erodes Social Security's ability to pay future benefits. The House and Senate bills manage to get around this fact only by using accounting gimmicks — the House bill relies on double-counting the surplus, the Senate bill relies on debt-financed transfers from the general fund to the Social Security trust fund. Third, no accounting gimmick can change the basic fact that as long as the rest of the federal budget is in deficit, surplus Social Security payroll taxes will be used to pay for other programs. Finally, private investment accounts are *not* Social Security. Social Security is a program that insures against the loss of wage income associated with old age, disability, or the death of a breadwinner. Private investment accounts are fundamentally different from insurance.

***Protecting the Social Security Surplus Requires Fiscal Responsibility* —** Everyone has known for at least the past several years that Social Security faced a long-term financing challenge that would put pressure on the rest of the federal budget. Despite this knowledge, Republicans have pursued a policy of permanent tax cuts that largely benefit the most well-off members of our society and make federal budget deficits worse. Over the next 75 years, the cost of the tax cuts just for the top one percent of taxpayers (those making over $300,000) is nearly equal to Social Security's entire estimated shortfall.

***Plans Fail to Address Social Security's Solvency Within the Larger Budget Context* —** Neither plan makes any meaningful contribution to strengthening Social Security for future generations. Borrowing money now to create private accounts and applying a corresponding reduction to future Social Security benefits amounts to little more than a shell game. The long-range gap between Social Security's costs and revenues remains. The Republican bills narrow that long-range gap slightly, but only because they assume that either general revenues will be transferred to Social Security to make up for the diversions into private accounts (the Senate bill), or that the private accounts will be funded out of general revenues directly (the House bill). Either way, that money has to come from somewhere, either by cutting spending, increasing revenues, or increasing the U.S. debt held by the public. Any plan that relies on new general revenues must be evaluated in the context of the plan's implications for the federal budget and deficits and debt as a whole. That is because the challenge facing Social Security is fundamentally a budget challenge.

***Uncertainty In 2017 and Beyond* —** The House and Senate bills fail to describe how the accounts would be funded in 2017 and thereafter, when Social Security surpluses are projected to dry up. Instead, the bills expect future Congresses to make decisions to extend the private-account program. This introduces even more uncertainty for today's workers trying to plan responsibly for their retirement. It also sets up a framework for accounts that are too small to serve any practical purpose. For example, a 21-year-old worker in 2016 who makes $25,000 would have one year of account contributions, totaling $50, because there is no Social Security surplus projected for 2017 and beyond. The administrative costs of maintaining that account until the worker retires would far exceed that amount.